



A Registered Investment Advisor

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## Is “Buy and Hold” Broken?

### **Does Asset Allocation Still Work?**

#### **Is there a better way?**

If you are like us, you had believed for years that the best investment strategy is a passive buy-and-hold approach. The mantra goes something like “it’s time in the market, not market timing.” We think this is a great strategy as long as in the end, the market always goes up. But the problem is the market does not always go up. Just look at the last twelve years as an example – it is now being labeled as “the lost decade.” And during the market corrections and bear markets, the buy and hold strategy can be very painful, particularly if retirement is approaching quickly.

### **Should you reconsider your strategy?**

A Buy and Hold/Asset Allocation strategy generally works well in “up markets”, but can be painful in down markets. If you are standing on the railroad tracks and you can hear/see a train coming, it may be a good idea to get off the tracks. But is this possible? The market is very difficult to figure out and all the pundits and economic experts rarely get it right. How can we hear the train coming?

### **Do Fundamentals still matter?**

In 2002 the Dow bottomed out around 7700 and in 2009 so far the low has been about 6500. Who would’ve thought we would be at this point again? We sure didn’t and we’re all frustrated. Many companies are still doing well yet their stock prices have been punished along with the rest of the market. The bottom line is: good companies’ stocks go down too. Some of America’s most idolized companies have lost 90% of their share value over the past 2 years. We need to look at more than just fundamentals.

### **Beyond Fundamentals: Technical Analysis**

Technical analysis is different than looking at fundamentals. It doesn’t matter how profitable a company is or if they are coming out with a hot product or if the company is positioned to take

advantage of a major shift in policy. It simply looks at chart trends. Is the company's stock in an uptrend or a downtrend? Or neutral?

## **So is Technical Analysis the solution?**

While technical analysis is not a perfect solution, it can provide an alternative way to listen for the train coming down the tracks. Fundamentally, we look at corporate profits, GDP growth, unemployment, inflation, Price/Earnings ratios, etc and try to determine if stocks are under/overvalued. We include rebalancing and other tactics to try and efficiently outperform the market. However, if following a fundamental asset allocation model you will mostly be fully invested 100% of the time. This is fine in normal market conditions, but very painful in down and volatile markets. A finely tuned asset allocation model does not call for you to get off the tracks, even if you do hear the train coming. It calls for "buy and hold."

Adding technical analysis to your arsenal will attempt to keep you invested when trends are up allowing for potential appreciation - **ADVANCE**. On the flip side if the trend starts down it will attempt to move you out of the market, into cash -**PROTECT**. It will never sell at the top or buy at the bottom because that is virtually impossible. The idea is to identify the uptrend and buy, and identify the downtrend and get out of the way. If successful, it helps protect much of the gains you've secured in the up market.

## **What is our strategy?**

Step #1: Fundamental Research—find good investment ideas.

We start with a review of available asset classes to invest in – this will include stocks, bonds, as well as alternative asset classes including commodities. Within each asset class we search for the investments which represent 'best in class' opportunities based on many factors including risk and reward.

We also have a stock model where we search for fundamentally strong companies based on the following criteria: sales growth, operating margin growth, earnings growth, balance sheet strength, free cash flow, return on equity, earning surprises, etc. We screen the entire universe of stocks and develop a list of around 30. This way we are sure we have some of the most fundamentally strong companies available

This step is the same as a typical asset allocation approach. It is the addition of step #2 which sets our strategy apart from most.

## Step #2: Technical Analysis

Using investments identified in step #1, we use our technical analysis program to ask a simple question—Is this investment in an uptrend? If the trend is up, the system may issue a buy order—**ADVANCE**. If the trend is down, we are not interested.

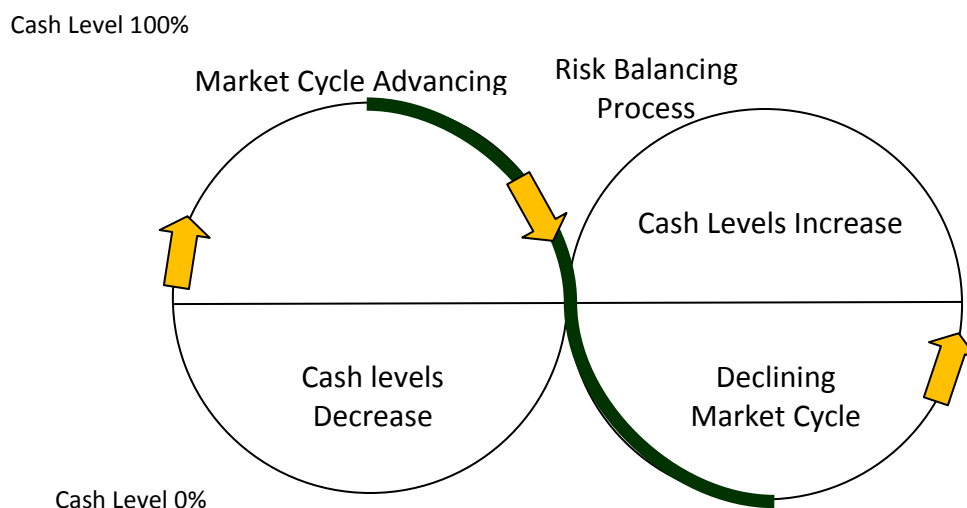
In an up market it is likely many of the investments we have selected will be in a confirmed uptrend and we may be heavily invested. In a down market, even the strongest fundamental investments may be in a downtrend and therefore we may own little or nothing. We would likely be mostly in cash, or in preservation mode—**PROTECT**.

In the second half of 2008 and early 2009, wouldn't it have been nice to have a large cash allocation to insulate your money from this bear market?

Imagine if your strategy guided you to avoid much of the tech bubble meltdown of 2000-2002 AND much of the subprime financial crisis of 2008-2009?

### Conclusion:

Buy and Hold generally is a good strategy when markets are going up, but it can be painful to “hold” when the markets are going down. Where are the markets headed next? While nobody knows for sure, it makes sense to employ a strategy that may be able to take advantage of any market environment. A more active approach which begins with investing in fundamentally strong investments only in an uptrend may be an approach for any market condition. Of course, in environments like last year, if there are no uptrends to be seen, a prudent action may be to “get off the tracks,” hold cash, and wait patiently for the next uptrend to begin.



## **Call to Action:**

If you are questioning the buy and hold strategy that you employ on your own or that your existing advisor has implemented, and you think there may be a better way, contact Elios Financial Group, Inc. at 440-617-9100 or go to [www.eliosfinancial.com](http://www.eliosfinancial.com).

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